DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 00-0462
Gross Retail Tax
For Tax Year 1997

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ISSUE

I. Gross Retail Tax— Credit

Authority: IC 6-2.5-3-4

Taxpayer protests the Department denying credit for sales tax paid.

II. Gross Retail Tax— Use Tax Paid to Another State

Authority: *Minneapolis Star and Tribune Company v. Minnesota Commissioner of Revenue*, 460 U.S. 575, 103 S.Ct. 1365 (1983); *Tyler Pipe Industries, Inc. v. Washington State Department of Revenue*, 483 U.S. 232, 107 S.Ct. 2810 (1987); *Allied Steel Company v. Larey*, 246 Ark. 1009, 440 S.W.2d 567 (1969); *Weeks Dredging & Contracting, Inc. v. Mississippi State Tax Commission*, 521 So.2d 884 (Miss. 1988); *Terrebonne Parish Sales and Use Tax Department v. Callais Cablevision, Inc.*, 433 So.2d 820 (La.App. 1st Cir. 1983)
IC 6-2.5-3-2; IC 6-2.5-3-5
45 IAC 2.2-3-16
68 Am.Jur. 2d, *Sales and Use Tax* § 188 (1993)
OAC § 5739.02

Taxpayer protests the assessment of tax on several purchases on which taxpayer contends it paid tax to other taxing jurisdictions.

III. Gross Retail Tax— Lump Sum Contract

Authority: IC 6-2.5-1-1
45 IAC 2.2-1-1; 45 IAC 2.2-3-9(d)(1); 45 IAC 2.2-4-22(e); 45 IAC 2.2-4-26(a); 50 IAC 4.2.4.10

Taxpayer protests the imposition of tax on materials used in improvements to taxpayer's real property.

IV. Gross Retail Tax— Duplicates

Authority: None

Taxpayer protests duplicate assessments of Indiana use tax on taxpayer's construction in progress account.

V. Gross Retail Tax— Duplicates

Authority: None

Taxpayer protests duplicate assessments of Indiana use tax on certain capital purchases.

VI. Gross Retail Tax— Credit for Overpayment of Use Tax

Authority: None

Taxpayer protests overpayment credits not given by the Audit Division.

VII. Gross Retail Tax— Software Licensing Agreements

Authority: IC 6-2.5-3-2(a)
Sales Tax Information Bulletin #8 (May 1983); *Sales Tax Information Bulletin #8* (February 1990)

Taxpayer protests the imposition of use tax on its software licensing agreements.

VIII. Gross Retail Tax— Sample Projection Methodology

Authority: *Floral Trade Council of Davis, California v. United States*, 16 CIT 1014 (CIT 1992)
IC 6-2.5-3-2; IC 6-2.5-4-6; IC 6-2.5-4-10(a); IC 6-2.5-4-11
45 IAC 2.2-3-27

Taxpayer protests the sample projection methodology used in the audit report.

STATEMENT OF FACTS

Taxpayer operates a riverboat casino in Indiana. The casino has offered daily gaming sessions to patrons since opening. The pavilion area where the patrons board the riverboat includes a gift shop, a bar, and several restaurants. Taxpayer later opened a hotel and an auditorium.

The Indiana Department of Revenue ("Department") conducted an audit for the tax year in question, and assessed additional use tax. The taxpayer filed a timely protest and a hearing was held. Additional facts will be supplied as necessary.

I. Gross Retail Tax— Credit

DISCUSSION

Taxpayer protests assessment of use tax on items contained in four invoices on which taxpayer claims sales tax has already been paid. Taxpayer argues credit should be given for the amount of sales tax paid on the invoices. Taxpayer has submitted further information as part of this protest. If this new information shows that sales tax has already been paid on this item, the same tax should not be paid again. IC 6-2.5-3-4. The Audit Division will need to review this information.

FINDING

Taxpayer's protest is sustained pending verification by the Audit Division.

II. Gross Retail Tax— Use Tax Paid to Another State

DISCUSSION

Taxpayer also protests the assessment of use tax on several purchases for which no credit was given for taxes paid to other states. IC 6-2.5-3-2 provides for the imposition of use tax on the "[s]torage, use, or consumption of tangible personal property in Indiana, if the property was acquired in a retail transaction . . ." Indiana allows a credit for payment of taxes paid to other taxing jurisdictions at the time of purchase. This credit is found in IC 6-2.5-3-5(a), which provides in pertinent part: "A person is entitled to a credit against the use tax imposed on the use, storage, or consumption of a particular item of tangible personal property equal to the amount, if any, of sales tax, purchase tax, or use tax paid to another state, territory, or possession of the United States for the acquisition of that property." *See also* 45 IAC 2.2-3-16.

A use tax ordinarily serves to complement the sales tax of a state by eliminating the incentive to make major purchases in states with lower sales taxes; it requires the resident who shops out-of-state to pay a use tax equal to the sales tax he saved by buying out-of-state. *Minneapolis Star and Tribune Company v. Minnesota Commissioner of Revenue*, 460 U.S. 575, 581-582, 103 S.Ct. 1365, 1370 (1983); 68 Am.Jur. 2d, *Sales and Use Tax* § 188 (1993). However, to alleviate or eliminate the potential multiple taxation that results when two or more states have jurisdiction to tax parts of the same chain of commercial events, most states which impose sales and use taxes provide a credit against their own sales or use taxes for sales or use taxes paid to another state. *Tyler Pipe Industries, Inc. v. Washington State Department of Revenue*, 483 U.S. 232, 245 n. 13, 107 S.Ct. 2810, 2819 n. 13 (1987).

Taxpayer argues that it is entitled to a credit against Indiana's use tax because it paid sales tax on its purchases to Ohio. The Audit Division argues that taxpayer is not entitled to the use tax credit in Indiana because the sales tax paid by taxpayer to Ohio was not owed to Ohio. Referencing an Ohio statute which exempts Ohio purchases from sales tax when they are shipped outside of Ohio, the Audit Division argues that, because the tangible personal property at issue was shipped to Indiana, the purchases were exempted from Ohio sales tax. Therefore, because the sales taxes at issue were exempted by Ohio, the sales taxes paid by taxpayer to Ohio were not owed there, and do not constitute a tax for which Indiana is bound to give a use tax credit. In other words, according to Audit, a taxpayer's erroneous payment of sales taxes to one taxing authority negates its entitlement to a credit for use taxes from another taxing authority.

There is ample authority from other states to support the Audit Division's interpretation of IC 6-2.5-3-5. *See, e.g., Allied Steel Company v. Larey*, 246 Ark. 1009, 440 S.W.2d 567 (1969), where the Arkansas Department of Revenue denied the use tax credit claimed for the Oklahoma use tax because the Oklahoma tax was paid before taxpayer became liable for it; *Weeks Dredging & Contracting, Inc. v. Mississippi State Tax Commission*, 521 So.2d 884 (Miss. 1988), where the Mississippi court concluded that a plain reading of the Mississippi use tax credit statute implied a requirement that the tax paid in another state be properly imposed before credit was due to prevent a taxpayer from paying even the most patently improper tax assessments in another state, gain an exemption in Mississippi, then gain a refund in the taxing state*; Terrebonne Parish Sales and Use Tax Department v. Callais Cablevision, Inc.*, 433 So.2d 820 (La.App. 1st Cir. 1983), where use tax credit was denied to taxpayer because the taxes for which a credit was sought were not legally owed to the other taxing authorities.

According to the Ohio Administrative Code, when tangible personal property is sold within the state of Ohio and the vendor is obligated to deliver the property to a point outside of the state, or to deliver the property to the mails for transportation to a point outside of the state, the Ohio sales tax does not apply. In the instant case, taxpayer made numerous purchases from an Ohio vendor. As part of the contract, the Ohio vendor shipped the purchases, which consisted mainly of computer equipment and supplies, to taxpayer via carrier, *i.e.*, UPS, and charged taxpayer for the costs thereof. The copies of invoices that taxpayer submitted as part of its protest show that taxpayer and the Ohio vendor agreed to the shipping term of F.O.B. Cincinnati. However, the fact that the parties designated Cincinnati as the F.O.B. point is irrelevant in this analysis because according to Ohio law, the taxable event occurs at the location at which a taxpayer exercises rights of ownership and control over the property. *See, Central Transport, Inc. et al., v. Tracy*, 649 N.E.2d 1210, 1212 (1995)

In the instant case, the evidence on files establishes that taxpayer exercised its rights of ownership over the computer equipment in Indiana. Accordingly, taxpayer's purchases of the equipment, designated for delivery and ultimate consumption within the state of Indiana, was not subject to Ohio sales tax. Because, Ohio sales tax was not due and payable on taxpayer's purchases, taxpayer is not entitled to an Indiana credit under 45 IAC 2.2-3-16. Instead, taxpayer's purchases are subject to Indiana use tax under IC 6-2.5-3-2 because the purchases constitute tangible personal property used or consumed in Indiana.

FINDING

The taxpayer's protest is denied.

III. Gross Retail Tax—Lump Sum Contract

DISCUSSION

Taxpayer entered into contracts with several vendors for the installation of a brick structured sign located at the entryway to taxpayer's property, the installation of a clock and a sauna, and the seal coating and asphalt repair of its parking lot. Taxpayer argues that these were lump sum contracts for the improvement of real property. The Department, however, maintains (1) that the contracts for the installation of the sign and the clock constitute unitary transactions, and (2) the contract for the installation of the sauna constitutes a time and material contract.

A taxpayer is not subject to use tax liability for those transactions for which taxpayer either issued a purchase order or contracted for an improvement to taxpayer's realty on the basis of lump sum contracts. Under 45 IAC 2.2-4-22(e):

> . . . With respect to construction material a contractor acquired tax-free, the contractor is liable for the use tax and must remit such tax (measured on the purchase price) to the Department of Revenue when he disposes of such property in the following manner:
>
> > (1) He converts the construction material into realty on land he owns and then sells the improved real estate;
> >
> > (2) He utilizes the construction material for his own benefit; or
> >
> > (3) Lump sum contract. *He converts the construction material into realty on land he does not own pursuant to a contract that includes all elements of cost in the total contract price*.

(Emphasis added).
Accordingly, the contractor will either pay the gross retail tax "up-front" when he initially purchases the construction materials or he will pay the gross retail tax in the form of use taxes when the materials are incorporated into the construction project. Either up-front or at the point where the materials are incorporated into the taxpayer's realty, in lump sum contracts between the taxpayer and its contractors, it is the contractors who are ultimately responsible for paying the tax on the construction materials. *See, e.g.*, 45 IAC 2.2-4-26(a) which provides that "[a] person [(*i.e.*, the contractor)] making a contract for the improvement to real estate whereby the material becoming a part of the improvement and the labor are quoted as one price is liable for the payment of sales tax on the purchase price of all material so used."

45 IAC 2.2-3-9(d)(1) provides that a contractor-retail merchant must collect gross state retail tax whenever he disposes of construction material by way of a time and material contract. A time and

material contract is a contract in which a contractor "converts the construction material into realty on land he does not own and states separately the cost for the construction material and the cost for the labor and other charges . . ." *Id.*

Taxpayer has provided documentation to support its contention that the seal coating and asphalt repair of its parking lot was provided for under a lump sum contract for making improvements to taxpayer's realty. However, taxpayer's invoice for the sauna was billed as a time and material contract, and not a lump sum contract. As such, the materials required to complete the sauna are subject to gross state retail tax. *See* 45 IAC 2.2-3-9(d)(1).

We also consider taxpayer's clock to be tangible personal property rather than an improvement to realty. Because taxpayer's purchases are for tangible property and not improvements to realty, the sales and use tax regulations governing lump sum contracts are not applicable. Moreover, because the invoices for the sign and the clock provide no breakdown of material and installation charges, the transactions are deemed unitary transactions and the entire charge on the invoice of both the sign and the clock is subject to gross state retail tax. (*See* I.C. 6-2.5-1-1 and 45 IAC 2.2-1-1 which provide that a transaction involving a retail sale of property in conjunction with a service can be classified as a unitary transaction. That transaction is subject to Indiana sales tax on the entire charge.)

FINDING

Taxpayer's protest is sustained with regard to the contract governing the seal coating and asphalt repair; however, taxpayer's protest is denied with regard to the contracts for the installation of the sauna, the sign and the clock.

IV. Gross Retail Tax— Duplicates

DISCUSSION

Taxpayer protests the assessment of use tax on its construction in progress ("CIP") account. The CIP account was originally held out of state because taxpayer's development company, which coordinates the construction of the casinos, is located there. The account was later transferred to Indiana. During the audit, the detailed invoices for the transactions occurring on the CIP account were available only at the out of state. As such, an Indiana-based auditor traveled to that location to review the asset purchases. However, because a different auditor reviewed the same asset purchases at taxpayer's Indiana property, taxpayer believes that the asset purchases for the CIP account were assessed use tax twice - once by the auditor working at the out of state location, and once by the auditor working in Indiana.

In support of its argument, taxpayer submitted a copy of its capital purchase exception schedule listing the CIP account purchases that were reviewed by the Indiana-based auditor at taxpayer's development company's out of state office. *See* Taxpayer's Exhibit I. If this exhibit shows that use tax was assessed on taxpayer's CIP account, the same tax should not be assessed again. The Audit Division will need to review this information.

FINDING

Taxpayer's protest is sustained pursuant to audit verification as to whether or not the asset purchases on the CIP account were subjected to double taxation.

V. Gross Retail Tax— Duplicates

DISCUSSION

Taxpayer protests the assessment of tax on several capital purchases for which taxpayer claims that use tax accrued and was remitted to the Department. Taxpayer has provided documentation evincing that use tax was indeed paid on the purchases in question.

FINDING

Taxpayer's protest is sustained subject to verification by the Audit Division.

VI. Gross Retail Tax— Credit for Overpayment of Use Tax

DISCUSSION

Taxpayer claims that in the months of November and December of 1997, estimated use tax payments were made. The amounts paid were over and above the actual amount of use tax that was due on taxpayer's purchases. Taxpayer claims a credit should be given for these overpayments. Taxpayer has provided invoice documentation of the overpayments, as well as the actual use tax due on the transactions, in Exhibits T and U of its supplemental documentation.

FINDING

Taxpayer's protest is sustained subject to the Audit Division's verification.

VII. Gross Retail Tax— Software Licensing Agreements

DISCUSSION

Taxpayer protests the imposition of use tax on its purchases of software and software licensing agreements. Examples of the software and licensing agreements purchased and used include application manager, query, general ledger, payables ledger, income reporting, fixed assets purchase management, inventory control, journal processor, cross applications, purchasing/payables exchange, security access, and human resources/payroll, as well as a third party software system. The use tax was imposed pursuant to IC 6-2.5-3-2(a) which provides that "an excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction. . ."

Taxpayer contends that the software and software licensing agreements are not subject to use tax because according to *Information Bulletin #8* (05/23/1983), *Sales Tax*, "a licensing arrangement whereby a licensee is entitled to limited use of a computer program for copying or other programming purposes is not subject to tax regardless whether the program is a custom program or pre-written program." However, the May 1983 Information Bulletin was revised in February of 1990. Within the February 1990, Sales Tax Information Bulletin #8, we find the following more relevant to the instant case:

> As a general rule, transactions involving computer software are not subject to Indiana Sales or Use Tax provided the software is in the form of a custom program *specifically designed* for the purchaser.
>
> Pre-written programs, not specifically designed for one purchaser, developed by the seller for sale or lease on the general market . . . are subject to tax irrespective of the fact that the program may require some modification for a purchaser's particular computer.

(Emphasis Added).

We wish to point out that Information Bulletin No. 8, dated May 23, 1983, also clarified the Department's position on software and software licensing systems. Page 2 of that Information Bulletin read in pertinent part as follows:

> Pre-written programs, not specifically designed for one purchaser, developed by the seller for sale or lease on the general market in the form of tangible personal property and sold or leased in the form of tangible personal property are subject to tax irrespective of the fact that the program may require some modification for a purchaser’s particular computer.

The nature of the licensed software, as well as the terms of the agreements, strongly suggests taxpayer licensed a *standard* business application software package. The Department finds that the programs and licensing agreements at issue in this audit are the type of canned, pre-written business application software which is available to all—even though the software might have been "modified" subsequently to meet taxpayer's specific needs. But even "modified," in this context, is not synonymous with "customized." Software can be "modified" in many ways; however, only the "writing" and "rewriting" of source code represents the creation of "custom" software.

FINDING

Taxpayer's protest is denied.

VIII. Gross Retail Tax— Sample Projection Methodology

DISCUSSION

Taxpayer protests the methodology of the sample projection used by the auditor to arrive at use tax owed for the audit period. The auditor used a block sampling method for the period January

1, 1997 through December 31, 1997. After an analysis of the taxable expenses for 1997 was conducted by taxpayer, it was agreed that the sample period of June, 1997 would be used for a projection of the expense accounts for the entire year. The expense records for purchases from the check register of payables from June 1 through June 30, 1997 were examined at one hundred percent (100%) to determine sales and use tax liability. A percentage error was calculated as follows:

> The amount found as taxable from chosen accounts in the sample was used as the numerator. The denominator was the total amount of the sample less the amount of invoices that were not posted to accounts that were chosen to be examined by the audit. To arrive at an amount for a proposed assessment of sales and use tax, the determined percentage was applied to the total amount of the account balances chosen for the sample.

See Audit Summary-Explanation of Adjustments, pg. 3.

Taxpayer protests the inclusion of six specific items in the use tax sample. These items will be addressed individually. Taxpayer also objects to the manner in which the error rate was calculated.

A. Extraordinary Items

In June 1997, taxpayer rented a large screen television as part of taxpayer's promotion for a major heavyweight title boxing match. According to taxpayer, because this item was a one-time rental, the expense should be removed from the calculation of the error rate and assessed separately as an extraordinary item. "Extraordinary expenses" generally will be excluded from sample populations to ensure the validity of the calculated error percentages.

The term "extraordinary expense" is not defined by our statutes or regulations. However, the Court of International Trade defines "extraordinary expense" as "unusual in nature and infrequent in occurrence." *Floral Trade Council of Davis, California v. United States,* 16 CIT 1014, 1016-17 (CIT 1992). Using the CIT's definition of the term as a guide, we first note that it is not far reaching that a casino would provide its patrons with the opportunity to view a boxing match. Casinos are popular venues for hosting prize fights. As such, it does not seem that a casino's providing pay-for-view boxing entertainment would be highly abnormal, unrelated or incidentally related to the casino's operations.

B. Use Tax Paid to Another State

Taxpayer revisits its earlier protest regarding the assessment of use tax on several purchases for which no credit was given for taxes paid to another state, *i.e.*, Ohio. According to taxpayer, the Audit Division erred in including in the calculation of error rate the transactions on which sales tax was paid to Ohio.

We have concluded already that because the transactions took place in interstate commerce and that taxpayer has not demonstrated that Ohio law required the payment of these taxes, the Ohio

sales tax was not properly paid. As such, said transactions should be included in the calculation of error rate.

C. Royalties

Taxpayer protests the inclusion of the use tax assessed on what taxpayer characterizes as a license royalty paid to another entity for a specialty stud poker game. Under IC 6-2.5-3-2, use tax is imposed on the "[s]torage, use, or consumption of tangible personal property in Indiana, if the property was acquired in a retail transaction…", unless an exemption is granted. Taxpayer asserts that it paid "royalty fees" to use the poker game, but does not owe use tax on the tangible personal property because the "royalty fees" are intangibles. Thus, taxpayer believes there is no basis for imposing use tax; and, as such, said transaction should be removed from the calculation of the error rate.

Taxpayer attempts to characterize its payments for the poker game as royalties; however, these payments are a clear example of licensing fees. IC 6-2.5-4-10(a) states in relevant part that a person is a retail merchant making a retail transaction when he rents or leases tangible personal property to another person. In the instant case, paying licensing fees for the privilege of using a casino game is tantamount to the renting or leasing of tangible personal property. Although taxpayer is not acquiring ownership rights to the poker game, it is purchasing the right to use the game for a period of time. The Audit Division rightfully imposed use tax on the fees paid for the use of the poker game. No error occurred here.

D. Satellite Television Programming

Taxpayer was assessed use tax on its purchase of a live television programming feed of a major heavyweight boxing match transmitted by satellite from an out-of-state source. Taxpayer claims that because the satellite service originated from outside of Indiana, the transmission did not meet the definition of telecommunication services. Taxpayer further claims that the transaction was not subject to use tax, and therefore should not have been included in the error rate, because the satellite programming did not constitute tangible personal property.

However, IC 6-2.5-4-6 states that certain types of "telecommunication services" are taxable. For the purpose of IC 6-2.5-4-6, satellite transmissions are considered "telecommunication services". IC 6-2.5-4-6(a) states:

> As used in this section, 'telecommunication services' means the transmission of messages or information by or using wire, cable, fiber optics, laser, microwave, radio, satellite, or similar facilities. The term does not include value added services in which computer processing applications are used to act on the form, content, code, or protocol of the information for purposes other than transmission.

In the instant case, taxpayer presented evidence at hearing establishing that it purchased the satellite feed for the boxing match directly from an out-of-state provider. Pursuant to the contract, the out-of-state provider was responsible for the delivery of the video and audio signal to taxpayer's communications satellite.

IC 6-2.5-4-11, which authorizes the taxation of certain cable television services, states in pertinent part: "A person is a retail merchant making a retail transaction when he furnishes local cable television service or intrastate cable television service." The Department considers cable television services and satellite broadcast services to be similar. While the amount of property and facilities located within the state necessary to ensure cable program differs from that necessary to ensure satellite program, this difference does not affect the taxable consequences of sales of the respective programming services. The Department finds, therefore, that the provision of television programming services via satellite – from standard fare to pay-per-view programming – represents a taxable sales transaction under IC 6-2.5-4-6. While the transaction is, and should have been, subject to sales tax as an enumerated service, the effect to taxpayer is as use tax and it is appropriate to consider it in the error rate.

E. Missing Invoice

Audit included one expense item in the sample period for which no invoice could be located. Since no invoice was available for examination, Audit assessed use tax on the purchase. Audit cites 45 IAC 2.2-3-27, which discusses documentation requirements:

> The person who stores, uses or consumes tangible personal property in Indiana may avoid paying the use tax to the Department if such person retains for inspection by the Indiana Department of Revenue a receipt evidencing payment of the tax.

Taxpayer identified the contested expense as one purchase (for $324.48) from a particular vendor (Wal-Mart). Taxpayer contends that based upon a purchase spreadsheet that taxpayer attached as an exhibit to its protest letter, "it is reasonable to say that we did in fact pay the sales tax to Wal-Mart at the time of purchase." Taxpayer further contends that it must have paid sales tax on the Wal-Mart purchases because as an in-state vendor that is registered to do business in Indiana, Wal-Mart must have charged sales tax on the purchases. However, it is well-settled that the burden of proof is on the taxpayer. Absent additional evidence presented by taxpayer that taxpayer actually paid the sales tax, the Department cannot rule in its favor.

F. Duplicate Invoices

Taxpayer claims the auditor included duplicate invoices in the calculation of the error rate. Taxpayer has provided a list of these duplicated invoices. Subject to verification by the Audit Division, these invoices should be removed from the error rate calculation.

G. Method of Assessment

(a) Taxpayer first disagrees with the manner in which the use tax error rate was applied against the expense accounts. According to taxpayer, if an expense account was found to have no errors, that account should not have been used to assess additional use tax liability on other expense purchases. However, taxpayer is mistaken. If the Audit Division found no error in a particular account, the calculation for the account equaled "zero". Therefore, it makes no

difference whether the Audit Division removes the account from the error rate or includes the account with a "zero" calculation. The result is the same.

(b) Taxpayer next disagrees with the manner in which the use tax error rate against the expense accounts was determined. Taxpayer points to its Exhibit W as proof that the Audit Division erred in determining the error rate. Taxpayer's Exhibit W is the Form AD-20-4 Workpaper that was created by the auditor. The exhibit shows that in calculating the error rate, the auditor used taxpayer's check register totals as the denominator in the formula for calculating the percentage rate of error. Taxpayer argues that the auditor should have used the monthly general ledger account balance totals as the denominator in the formula. We agree. However, the denominator should include the general ledger account balances for all of the examined expense accounts, whether or not a particular expense account was found to have use tax errors.

FINDING

Taxpayer's protest is denied on issues A, B,C, D, E, and G(a). Taxpayer's protest is sustained pending Audit Division verification on issue F. Taxpayer's protest is sustained on issue G(b) subject to taxpayer's ability to supply the Audit Division with the necessary documentation to correct the use tax error rate.

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